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# Bilateral Investment Treaties and Sovereignty: An Analysis with Respect to International Investment Law

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## Abstract

International law as a governing institution, has gained prominence, with the advent of globalization. This is of specific relevance for the governance of state-market relations. Nowhere has this been as pronounced as in the international investment regime. Bilateral Investment Treaties (BITs) have today become some of the most potent legal tools underwriting economic globalization. These are established through pacts, which have to be adhered to, through all stages of performance of the treaty. This paper argues against the shift of bilateral investment treaties (BIT) from a pro-sovereign, to a pro-investor approach. It does so by explaining the present situation of bilateral investment treaties while pointing out their disadvantages. The basic idea of a BIT is questioned in order to understand its purpose and examines its failure in achieving the same. The partial approach towards the investors by the tribunals, is frowned upon and the lack of justifications and defenses on the part of the state is reviewed. Modest suggestions on improving this situation are provided by using cases decided by tribunals at an international level, taking up the example of Argentina.

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## I. Introduction

A perusal of the history of investments involving state(s) and investor(s) clarifies that a major shift has occurred from a pro-sovereign attitude, to a pro-investor attitude. Jean Bodin<sup>1</sup>, whose theory on sovereignty is well known, propounded that the ruler proclaims absolute sovereignty. It meant that the ruler is not legally responsible for the exercise of his power to any superior authority.<sup>2</sup> Absolute sovereignty in its classical meaning represents an internal concept which entitles a ruler to exercise supreme authority within his territory. It is not an external concept that would exonerate him from commitments to which he would have consented to, under international investment law (IIL).<sup>3</sup> Sovereignty in modern IIL, prescribes the legal status of a state to be within and not above it. This denotes an independent structure whereby much power and authority is available at the state's disposal. Recent trends in other regions of law have observed an increasing retreat of the freedom of the state's consent to submit to international order, thereby affecting its direct subjectivity to IIL. This has in return, affected territorial integrity, exclusive personal and territorial jurisdiction, cultural identity and freedom of self-determination over political and socio-economic affairs.

Globalization, defined as the internationalization of societies and economies has led to the spread of capitalism.<sup>4</sup> This has further led to the transformation of the laws and norms followed within a country to match an international model. As the sovereignty lies upon these very laws and norms, the law too is metamorphosing

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<sup>1</sup> Jean Bodin, *Les six livres de la republicae* (1576).

<sup>2</sup> H. Steinberger, *Sovereignty*, in 10/12 *Encyclopedia of public int'l law* 397, 402 (Bernhardt ed., 1987).

<sup>3</sup> *Id.* at 403-407.

<sup>4</sup> Julian Ku et. al., *Globalization and Sovereignty*, 31 *Berkeley J. Int'l Law* 210, 210 (2013).

internal sovereignty.<sup>5</sup> Post World War II, Bilateral Investment Treaties (BITs), guaranteed a standard of treatment for investors and provided a mechanism for addressing disputes that arose between the parties to these treaties.<sup>6</sup> Such agreements rob the states of their sovereign immunity making themselves vulnerable to legal claims by foreign litigants, alleging breach in the promised commitments. The exercise of sovereignty of the state comes into question as the investor's return on investment goes contrary to the sovereign's role in regulation of economic affairs. Therefore, when the government's ability to exercise internal sovereignty is threatened, the idea of democracy itself is threatened. Protectionism, competitive deregulation or subsidization of any particular industry will not insulate the government against the challenges of globalization.<sup>7</sup>

## II. Impact of Pro-Investor Based Investments on Countries

Foreign investment is a vital tool for economic development and global prosperity. It allows developing countries to enhance local industries and receive funds from foreign investors to improve infrastructure. Meanwhile, investors obtain financial returns and gain foothold in the markets of those countries.<sup>8</sup> The disputes that have arisen in this area have been looked into by many tribunals at the international level. Over the years, the tribunals have passed arbitral awards, both in favour of, and against the sovereign. In allowing the public and private concerns to balance out between legitimate and protectionist regulations, if the investment treaties are interpreted exclusively from an investment perspective, the balance is ruined. By leaving out concerns of the sovereign and

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<sup>5</sup> Schreuer, *The Waning of the Sovereign State*, 4 Eur. J. Int'l Law 447, 447 (1993).

<sup>6</sup> Jeswald W. Salacuse, *The Law of Investment Treaties* 1 (Oxford International Library, 2nd ed., 2010).

<sup>7</sup> Wolfgang Rinicke, *Global Public Policy* (Oct. 22, 2014), <http://www.foreignaffairs.com/articles/53586/wolfgang-h-reinicke/global-public-policy>.

<sup>8</sup> Marian Nash, *Bilateral Investment Treaties United States-Argentina*, 87 Am. J. Int'l L. 433, 433 (1993).

focusing solely on profits and returns on investment, the investors' values tend to dominate.<sup>9</sup>

In not being involved with the creation of the constitution, choosing its framers or participating in elections, the investors have unjustly claimed themselves to be more vulnerable to such legislations. This was held by the International Arbitral Tribunal to be a sufficient ground for indirect expropriation, which would necessitate compensation.<sup>10</sup> Indirect expropriation also includes a situation where the state, by means of legislative procedures, brings about a minor change in the terms of the contract. This handicaps the investor from recovering the entire rents of business under the original contractual framework.<sup>11</sup> The author contends that this logic is flawed. If it were true, then no legislation could be enacted once the investors enter the market of the host state. This decision is contradicted in the *Enron case*,<sup>12</sup> where Argentina was excused from expropriation, as it employed many emergency measures, out of economic necessity during the time of financial crisis. This arbitral award was subsequently annulled which reduces the worth of the sovereign. Taking into consideration the needs of a country that is going through a financial crisis, against the temporary losses of a globally established corporate network, the author firmly believes that the sovereign should be given priority. It is imperative that the government initiates such a measure as it is a matter of public policy and necessity.

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<sup>9</sup> Barnali Choudhury, *Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?*, 41/3 Vand. J. Transnat'l L. 775, 775 (2008).

<sup>10</sup> *Tecmed v. Mexico*, ICSID Case No: ARB(AF)/00/2, 29 May 2003, 431 I.L.M 133(2004).

<sup>11</sup> Francesco Gelmetti, *Indirect Expropriation under International Investment Law* (Oct. 24, 2014), [https://www.academia.edu/5551868/Indirect\\_expropriation\\_under\\_international\\_investment\\_law](https://www.academia.edu/5551868/Indirect_expropriation_under_international_investment_law).

<sup>12</sup> *Enron Corporation Ponderosa Assets L.P v. Argentine Republic*, ICSID No. ARB/01/3, 22 May 2007, AL RA 21 (2007).

Even beyond the losses of the investor, irreparable damages to the environment and the health of the populace may be caused, if the BIT doesn't specify the terms of the cleanup after the agreement is terminated. The damage caused by the Chevron-Texaco company was so immense that the judiciary of Ecuador imposed a fine of \$8 billion on them, for repairing the damages caused to the environment. This recent case has laid down a much important aspect of re-negotiating all existing BITs, as a blind incorporation of model BIT clauses will not respect the technical distinctiveness of each agreement. Each BIT requires its own draft and model that suits the case in hand. Argentina, which emerged successful after a financial crisis, witnessed a movement that was strongly in favour of the investors. This is supported by the fact that most of the cases involving Argentina, have been decided against the sovereign.<sup>13</sup> A set-back of \$450 million, along with accrued interest, resulted in Argentina battling with four settlements in the 2005-08 period. Most of this involved, the breach of standards of fair and equitable treatment. Thus, it is observed that, in deciding these cases, the International Centre for Settlement of Investment Disputes (ICSID) tribunal has consistently taken a pro-investor stance. However, a contrary approach was noticed in the case of *Saluka*, where the tribunal stated as follows:

...protection of foreign investment is not the sole aim of the treaty... a balanced approach for both parties... the host state possess a legitimate right to regulate domestic matters in the public interest...<sup>14</sup>

Thus, the rights of the state are equally important in a BIT between two countries. There should exist a counterbalance in the treatment to be accorded to the investor. If so, why is there an imbalance in the level of support accorded to the parties in awarding pro-investor awards?

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<sup>13</sup> CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8, 25 Sept. 2007; Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, 14 July 2006.

<sup>14</sup>Saluka Investments B.V. v. Czech Republic, 17 March 2006, PCA IIC 210 (2006).

Apart from the above discussed topics, the right of the state to induce regulations reflective of public morals and policies is also important. Therefore, even without instances of necessity, the state should be allowed to create legislations for the general development of its public policy. As seen in the example of Argentina, the people of the state were deprived of their money as they were penalized in millions, by the tribunals. Hence it is inappropriate for a country to set aside a major part of its budget, for the purpose of paying off dues under the compulsion of BIT. Ideally, BIT is expected to expedite a country's growth, and propel its economy. However, this also triggers an increase in the divide between developed and developing nations. Currently, there exist many defenses for the state's acts. Though these defenses have not been used extensively in the last decade, it is important to understand them. These include force majeure, coercion and duress, necessity, corruption and fundamental change of circumstances.<sup>15</sup> Although the last decade witnessed an increase in the number of countries utilizing the provisions of the BIT, the above mentioned defenses have never been invoked, inspite of these provisions being assumed to be part of every agreement entered into between the parties.<sup>16</sup>

It is established that there exists an increasing dissatisfaction towards investor-state arbitration. Albeit a recent development, the IIL will have relevance in the coming future. In the absence of a global comprehensive convention on how to address disputes that arise in such an instance, it is necessary to have a clear model BIT. ICSID and such similar tribunals will be in charge of the arbitration procedure but the change has to begin at the roots of the agreement. The author believes that he has, by now established that there exists an order which promotes investors in every dispute. This modern trend is not only dangerous for the future but also affects the faith of parties to such agreements. Under such circumstances what alterations should be made to the existing procedure and regulations, so that this dwindling character of investment laws is reversed? Primarily, the present BITs require re-

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<sup>15</sup> R. Doak Bishop Et. Al., *Foreign Investment Disputes, Cases, Materials and Commentary* 1171 (Kluwer International Law, 2014).

<sup>16</sup> *Id* at 1171.

negotiation to include all the defenses discussed. Among these, Force majeure and public policy are the most important ones. Without restricted grant of defenses, the tribunals need to look into the case for the merits of the facts and take note that the judgement awarded by them has far-reaching effects. Such an award should not be overbearing on either of the parties. Acts performed under necessities of state character must be taken for dispute resolution and not be complained about. The sovereign is required to design the measure against the investor during socio-economic emergency. On the investment horizon, the investor has a well-established stance, complete with rules, defenses and standards.

To suggest modest measures like settling the disputes within themselves or to even further their business relations by repeating investments with renewed and re-negotiated BITs will allow both parties to raise a monetary fund to repair the previous losses and also to add on to profits. The voluntary action that countries deserve at this point of time is to consent or elect to appoint themselves as part of the convention. With much mainstream movement, the smaller countries need the delicate care to adapt themselves to globalization. In the cases of Argentina and other Latin American countries, the ICSID has awarded huge sums against them, warding them off and influencing them to exit from such dangerous ventures. Moreover, governments that sign treaties are always changing in this world, which has a penchant for democracy. Thus, when the drafts are being made, it is essential to note that the agreement has a provision for re-negotiation and has a solid foundation. Countries like Germany, China and Morocco have initiated the renegotiation of BIT.

### **III. Conclusion**

It can be argued that the international stance on BITs is largely partial towards the investor, and that there has been a shift from a pro-sovereign attitude to a pro-investor attitude. Over the recent years, the number of BITs that have been signed is astronomical. Hence it is now important to develop BITs that cater to the needs of the parties as discussed in this paper. The defenses have to be recorded in writing the BITs and the terms of agreement and environmental conditions have to be specified. Smaller, younger

and lesser developed countries require the incentive to sign more BITs and stop evading such ventures. For this, the tribunals need to stop intimidating these countries by awarding huge amounts against them. By providing more provisions for reconciling and repairing damages, the institutions of arbitration can control the success of IIL. The examples of Argentina and other Latin American countries bear witness to what the fractional attitude towards the investor amounts to. It is only fair that the sovereign is also granted defenses to support its claim. In view of this, the author has suggested some modest defenses that can help bridge the divide between the investor and the state.